IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF IDAHO

IN RE	)	
	)	**Case No. 99-01906**
MICHAEL T. CRACCHIOLO dba BOISE AUTO BROKERS,	)	
	)	
Debtor.	)	
_____	)	
	)	
FARMERS & MERCHANTS STATE BANK,	)	**Adv. No. 99-6268**
	)	
Plaintiff,	)	**MEMORANDUM OF DECISION**
	)	
vs.	)	
	)	
MICHAEL T. CRACCHIOLO,	)	
	)	
Defendant.	)	
_____	)	

Terry C. Copple, Boise, Idaho, for Plaintiff.

D. Blair Clark, Boise, Idaho, for Defendant.

I. Background

Plaintiff Farmers and Merchants State Bank asserts a debt owed Plaintiff by Defendant Michael Cracchiolo, a Chapter 7 debtor, should be excepted from discharge under Section 523(a) of the Bankruptcy Code. A trial in this adversary proceeding was held on April 13, 2000, at which the parties

submitted evidence, testimony, and argument. The matter was taken under advisement. After due consideration of the record and the arguments of the parties, the following constitutes the Court's findings of fact and conclusions of law. Fed. R. Bankr. Proc. 7052.

II. Facts

There are issues of disputed fact presented to the Court in connection with the disposition of this action. The credibility of the witnesses called to testify at trial was a factor duly considered by the Court in resolving the issues of fact. Having assigned appropriate weight to the testimony of the witnesses after observing them testify, and having considered all the evidence produced by the parties at trial, the Court finds the facts to be as follows.

Defendant Michael Cracchiolo filed for Chapter 7 relief on July 26, 1999. Defendant, at the time he filed his bankruptcy petition and for several years before, was engaged in the business of selling used automobiles, most recently in Boise doing business as Boise Auto Brokers.

In early September, 1998, Defendant purchased a 1994 Lotus high performance sports car from an auto auction in California for $31,150. He purchased the vehicle for resale through his Boise dealership. Within a few

days of bringing the Lotus to Boise, Defendant sold it to another Boise car dealer, Fairly Reliable Bob's ("Bob's"), for resale to a Bob's customer. Defendant was paid the sales price for the vehicle. However, when Bob's customer failed to purchase the vehicle, Defendant agreed to "repurchase" the Lotus. Defendant obtained a loan from Bank of America to finance the repurchase, and he granted Bank of America a security interest in the Lotus to secure repayment of the loan. On September 23, 1998, Defendant and Bank of America applied to the Idaho Department of Motor Vehicles ("DMV") for issuance of an "electronic title" on the vehicle showing Defendant as the owner, and Bank of America as the lienholder. The parties surrendered the California certificate of title to DMV as part of this application. According to its records, the Idaho electronic title was "issued" by DMV on October 16, 1998.[1]

In November, 1998, Defendant met with Plaintiff's representative, Mr. Richard Toney, a branch manager and experienced loan officer. Defendant had previously borrowed money from Plaintiff, securing the loan with a security interest in a Mercedes automobile. That loan was repaid as agreed. Defendant applied to Plaintiff for a loan of $31,260, to be secured by a security interest in

[1] "Issuance," as the Court understands the system in use, involves creation of an electronically stored record regarding this transaction and vehicle; no "paper" title certificate is created at that time.

the Lotus. Defendant represented he needed the money to "put back in his business" for unspecified uses. Mr. Toney agreed to make the loan to Defendant. While Mr. Toney was told and understood that Defendant, as a used car dealer, intended to resell the Lotus, Mr. Toney structured the loan to Defendant as a "consumer loan."[2] The loan was to be repaid in 59 monthly installments, including interest, and was to be secured by noting Plaintiff's security interest on the certificate of title.[3]

The loan and security documents were dated and signed by Defendant on November 23, 1998. The loan proceeds were disbursed when, along with some of Defendant's other funds, a cashier's check for $32,437.68 was issued by Plaintiff payable to Bank of America. Notably, Mr. Toney did not ask to inspect the Lotus, nor did Mr. Toney require presentation of the motor

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[2] In reality, this loan was a commercial transaction by any definition. Defendant was not using the loan proceeds to purchase the vehicle, but instead wanted the funds for use in his business. While he may have intended to drive the Lotus, it was most certainly part of his "inventory" of similar expensive, distinctive used cars held for resale. Plaintiff's agent was aware of the business nature of this loan transaction from the beginning.

[3] This approach to perfection of Plaintiff's security interest is also suspect, or at least naive, under these facts. Idaho Code 49-512 makes clear that while notation of the lien on the title is the exclusive method for perfecting a security interest in motor vehicles for most purposes, it does not apply to vehicles held by the debtor as inventory for resale. A UCC-1 financing statement should have been recorded to perfect Plaintiff's interest. While not an issue in this dischargeability action, Plaintiff's lien in the Lotus may have been avoidable by the trustee in the Chapter 7 case as not properly perfected per 11 U.S.C. § 544(a).

vehicle title to the Lotus to him as a condition of disbursement of the loan proceeds to Defendant. Instead, Mr. Toney testified, because Defendant was a "dealer," he asked Defendant to have a title certificate issued on the Lotus by DMV with Plaintiff's lien noted on that title. Defendant agreed to do so, and to return the title showing Plaintiff's perfected security interest to Mr. Toney when issued.

While not altogether clear, it appears Defendant used Plaintiff's loan proceeds to pay off the obligation to Bank of America. The payoff, according to documents admitted in evidence, was accomplished on November 27, 1998. While what transpired in the interim is unclear, it was not until February 26, 1999, that Bank of America representatives acknowledged the payment in writing, and it was not until March 8, 1999, that Bank of America agents forwarded the necessary information to Idaho DMV so that Bank of America's lien on the vehicle could be released and a "clean" title certificate issued to Defendant.

Defendant denies he ever received the reissued title certificate. When he inquired about the title, he was told by DMV agents it had been issued and picked up at their counter, although no receipt for the title was produced to the Court. Mr. Toney, in the interim, made repeated contacts with Defendant

concerning obtaining a proper title on the Lotus. However, in part since Defendant was current on the monthly payments on Plaintiff's loan, Plaintiff took no formal action concerning lack of a title.

In April, 1999, Defendant, who was by now discouraged in his attempts to sell the Lotus in Boise, sent the vehicle back to the California auto auction in anticipation of selling it. In addition, Defendant had become indebted to the owners of Cove Motoring, Inc. ("Cove"), a California dealer with whom Defendant had done business. Defendant testified he owed Cove an estimated $50,000 to $100,000 at this time. Mr. Schwartz, the owner of Cove, pressured Defendant to either pay his debts or to provide Cove with security for the obligations. Defendant testified he agreed to send Schwartz the vehicle title to "hold" until Defendant could pay his debt to Cove.

When Defendant could not locate the title to the Lotus, he applied to DMV for issuance of a duplicate title. On April 2, 1999, he filed an application attesting the title certificate had been lost. However, instead of having the duplicate title show Plaintiff as the holder of a lien on the vehicle, he represented in the title application there were no liens on the vehicle, and had a second "clean" title issued. Defendant's employee picked up the title certificate at the DMV counter. Shortly thereafter, in turn, a Cove employee picked up the title

from Defendant and took it to Schwartz in Boise.[4] When questioned about why Plaintiff's lien was not noted on this title, Defendant explained if he had requested such, it would have taken longer to have the title issued, thereby slowing down the process of getting the title to California so the car could be sold and Plaintiff paid.

When Mr. Toney continued to call about the title, Defendant contacted Schwartz and asked him to send back the title because Plaintiff had a lien on the auto, and was demanding a title certificate be produced. Schwartz allegedly told Defendant it would be mailed to him.[5] When the certificate did not

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[4] Defendant's courtroom story regarding Cove, Schwartz, and the duplicate title are inconsistent with the contents of his sworn responses to interrogatories propounded to him by Plaintiff prior to trial, which state:

> Debtor owed money to Paul Schwartz for another vehicle. Mr. Schwartz demanded some sort of security for his money, which was about $35,000. The Lotus was at Mr. Schwartz's lot for resale. Schwartz sent an "enforcer" to Boise to get the title to the Lotus, and threatened bodily harm to Debtor if he did not give the title plus $5,000. This was done at the Boise Airport, in approximately March, 1999, about six weeks before the duplicate title was issued. Debtor was told that the vehicle and title were simply being held as collateral.

Defendant's Response to Plaintiff's First Set of Interrogatories, Response to Interrogatory No. 5, pg. 4, Trial Exhibit 10.

[5] The record is unclear as to whether Defendant had paid Cove at the time he was requesting Schwartz return the Lotus title to him (which, frankly, the Court doubts occurred) or why Schwartz would return the title without payment.

arrive in the mail after some time, on April 28, 1999, Defendant filed an application with DMV for issuance of another duplicate title, this time asking that Plaintiff's security interest be noted on the title. The second duplicate was issued in May, and the title certificate forwarded directly to Plaintiff, where it remains in its loan files.

Unfortunately, and as a result of events Defendant cannot adequately or plausibly explain, before issuance of the second duplicate Idaho certificate, a title to the Lotus was issued to Cove in the State of California. Documents admitted into evidence from the California Department of Motor Vehicles show a "sale" from Defendant to Cove occurred on April 6, 1999, and allegedly show Defendant signed both the Idaho title certificate (i.e., the "first" duplicate) and the application for issuance of a new California title on April 8. Defendant admits having "signed off" on the title certificate, but claims his signature on the California application for a new title was forged. Defendant never explained how Cove obtained possession of the vehicle from the auto auction.

Plaintiff was, in theory, blissfully unaware of its predicament, now having a title certificate in its files, with Defendant continuing to make payments on the loan up through July, 1999. Then, while reading a list of new bankruptcy

filings, Mr. Toney noticed that Defendant had filed for bankruptcy relief.[6] Mr. Toney inquired with the Chapter 7 trustee about the case, and found no information concerning the Lotus. Plaintiff has taken no action to recover the vehicle from Cove (or whomever the current owner may be). It is Plaintiff's position that it's security interest in the Lotus has been rendered valueless by Defendant's actions and that the title certificate it holds in its files is invalid.

Plaintiff filed the present action against Defendant on November 2, 1999.

III. Discussion

Plaintiff cites two provisions of the Bankruptcy Code, Sections 523(a)(2)(A) and 523(a)(6), which, it contends, should serve as a basis for declaring Defendant's debt to Plaintiff nondischargeable.

A. Section 523(a)(2)(A)

Section 523(a)(2)(A) excepts from discharge any debt obtained through "false pretenses, a false representation, or actual fraud." 11 U.S.C. §

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[6] Plaintiff contends it was not listed by Defendant as a creditor in Defendant's bankruptcy schedules and received no formal notice of Defendant's bankruptcy filing. Defendant offers no adequate explanation of why Plaintiff was omitted from his schedules.

523(a)(2)(A). A creditor must prove[7] that: (1) the defendant made a representation; (2) which at the time the defendant knew was false; (3) the representation was made with the intent to deceive; (4) the plaintiff relied on the representation; and (5) the plaintiff sustained the alleged loss as the proximate result of the representation. *American Express v. Hashemi (In re Hashemi)*, 104 F.3d 1122, 1125 (9th Cir. 1996), cert. denied, 520 U.S. 1230 (1997).

1. False Representation

Plaintiff asserts Defendant made the following false representations: (1) that Defendant paid cash to purchase the Lotus; (2) that Defendant wanted to use the loan proceeds to put in the business; and (3) that he was the owner of the Lotus and it was free and clear of any liens.

Plaintiff argues Defendant misled Mr. Toney when, in applying for a loan from Plaintiff, Defendant told Mr. Toney that Defendant had paid cash for the Lotus. A copy of an invoice from the California Auto Dealers Exchange ("CADE") was received in evidence, a document Plaintiff contends was used by Defendant to confirm to Mr. Toney that Defendant paid cash for the Lotus on September 2, 1998. The Court has no reason to question the accuracy of the

[7] The standard of proof for actions under Section 523(a) is preponderance of the evidence. *Grogan v. Garner*, 498 U.S. 279, 291 (1991).

testimony or the authenticity of the document. In other words, Defendant had in fact purchased the vehicle for cash at one time. However, several weeks later, Defendant sold the car to another dealer, Bob's. When the sale to Bob's customer fell through, Defendant agreed to repurchase the Lotus from Bob's. This repurchase was financed with a loan obtained through Bank of America. An electronic certificate of title listed Bank of America as the lienholder in the Lotus. Thus, on November 20, 1998, when Defendant applied for a loan with Plaintiff, the facts show that while Defendant had paid cash for the Lotus at one time, there was an outstanding lien held against the vehicle. This is a fact of considerable significance to a potential lender. Defendant's statement to Mr. Toney that he had paid cash for the Lotus implied that it was free of competing liens. In fact, it was not, and this statement amounts to a false representation.

Plaintiff next asserts Defendant made another false representation when he told Mr. Toney that he intended to use the loan proceeds in the business. Defendant evidently used the proceeds to pay off the Bank of America obligation. To the Court, Defendant's representation in this regard was not false because in paying off the prior debt, Defendant was in fact using the loan proceeds in his business.

Plaintiff also contends Defendant falsely represented he would obtain a certificate of title with a notation of Plaintiff's secured interest. Defendant ultimately obtained a certificate of title with the notation of Plaintiff's lien interest. While such a title was not obtained until after the car had been delivered to Cove in California (and by then possibly even sold), Defendant's statement was not false because Defendant did indeed obtain the title with the notation of Plaintiff's interest in the vehicle.

Finally, Plaintiff asserts Defendant represented in Plaintiff's loan documents that the Lotus was free and clear of liens. It was not. Defendant knew an electronic title certificate had been issued on October 16, 1998, listing Bank of America as the lienholder on the Lotus. This representation made by Defendant on the loan application on November 20, 1998, was false.

2. Intent to Deceive

Intent to deceive is a question of fact which may be inferred from the surrounding circumstances of the case. *Cowen v. Kennedy (In re Kennedy)*, 108 F.3d 1015, 1018 (9th Cir. 1997). Here, Defendant knew critical facts about the Lotus, such as the fact it had once been purchased for cash, then sold, then purchased again with financing from Bank of America. Defendant also knew Bank of America held a perfected security interest in the Lotus. The

circumstances suggest Defendant withheld these critical facts from Mr. Toney in order to obtain a loan from Plaintiff. The Court concludes Defendant did so to deceive Plaintiff.

3. Reliance

A creditor must show it relied upon a debtor's false representation to except a debt from discharge. Section 523(a)(2)(A) requires the creditor's reliance on the false statements be justifiable, not merely reasonable. *Field v. Mans*, 516 U.S. 59, 70-71 (1995). In determining whether a creditor must investigate the facts represented by a debtor to obtain a loan, the Supreme Court instructs "'it is only where, under the circumstances, the facts should be apparent to one of [creditor's] knowledge and intelligence from a cursory glance, or he has discovered something which should serve as a warning that he is being deceived, that he is required to make an investigation of his own.'" *Id.* at 71 (quoting W. Prosser, Law of Torts § 108, p. 718 (4th ed. 1971)). Whether a creditor has justifiably relied is a subjective standard. *Tallant v. Kaufman (In re Tallant)*, 218 B.R. 58, 67 (9th Cir. B.A.P. 1998).

Here, Mr. Toney undoubtedly relied upon Defendant's representations that he paid cash for the Lotus and that the vehicle was free of liens. The inquiry does not end here. Was Mr. Toney justified in relying upon

these representations? Obviously, Plaintiff could have verified Defendant's statements by requiring Defendant to produce a clean certificate of title. In the Court's experience, such a requirement would constitute a minimal act of lender prudence under the circumstances. Plaintiff did not require Defendant to produce a title showing he owned the Lotus free and clear, nor did Plaintiff take any affirmative steps to check on the status of the title at DMV. This lack of diligence continued even after the loan was made by Plaintiff to Defendant. Plaintiff took no action to insure its lien interest was noted on a new certificate of title. It appears Plaintiff was content with the situation as long as Defendant was current in his payments on the loan. As an experienced, professional lender, Plaintiff (and Mr. Toney in particular) should not have blindly relied upon Defendant's promises to protect Plaintiff's interests under these circumstances. The fact that Defendant may have been a dealer does not excuse Plaintiff's failure to take even minimal steps to discover the truth and to perfect its security interest.

The Court concludes Plaintiff has failed to prove it was justified in relying upon Defendant's false and deceptive statements. Accordingly, Plaintiff's claim for relief from discharge under Section 523(a)(2)(A) fails.

B. Section 523(a)(6)

Under Section 523(a)(6), any debt for a willful and malicious injury by the debtor to the property of another is excepted from the debtor's bankruptcy discharge. 11 U.S.C. § 523(a)(6). To be considered willful, the debtor must commit an act akin to an intentional tort under state law, and the debtor must intend the consequences or injury resulting from the act rather than just the act itself. *Kawaauhau v. Geiger*, 523 U.S. 57, 61-62 (1998). This standard requires more than a reckless or negligent act. *Id.*

Plaintiff suggests Defendant willfully and maliciously converted its collateral. "The conversion of another's property without his knowledge or consent, done intentionally and without justification and excuse, to the other's injury, constitutes a willful and malicious injury within the meaning of [Section] 523(a)(6)." *Del Bino v. Bailey (In re Bailey)*, 197 F.3d 997, 1000 (9th Cir. 1999) (quoting *Transamerica Commercial Financial Corp. v. Littleton*, 942 F.2d 551, 554 (9th Cir. 1994)). However, in *Geiger,* the Court discussed *McIntyre v. Kavanaugh*, 242 U.S. 138 (1916), a case holding that a judgment for conversion fell within the discharge exception. The Court noted "that not every tort judgment for conversion is exempt from discharge." *Geiger*, 523 U.S. at 64. If the conversion is a result of a negligent or reckless act , it will not qualify as "willful and malicious" under Section 523(a)(6). *Id.*

While bankruptcy law governs whether Plaintiff's claim is nondischargeable under Section 523(a)(6), the Court looks to Idaho law to determine whether an act constitutes conversion. *See Bailey*, 197 F.3d at 1000. Conversion is generally defined as an "act of dominion wrongfully asserted over another's personal property in denial of or inconsistent with rights therein." *Peasley Transfer & Storage Co. v. Smith*, 979 P.2d 605, 616 (Idaho 1999).

Here, Plaintiff and Defendant executed a security agreement on November 23, 1998. Plaintiff's Exhibit 4. In that agreement, Defendant granted Plaintiff a security interest in the Lotus. Defendant represented he would not sell or dispose of the car without Plaintiff's consent.

Plaintiff's security interest was not noted on the certificate of title as required by Idaho law until after Defendant had disposed of the Lotus by sending it to California. Defendant testified he promised Mr. Toney that Plaintiff would be recognized on the certificate of title as a lienholder. Defendant also testified that as a car dealer, he knew the importance of listing Plaintiff on the certificate of title, and appreciated that the failure to do so would prevent Plaintiff from perfecting its lien. *See* Idaho Code §§ 49-510; 49-504. With such knowledge, on April 2, 1999, Defendant applied for a certificate of title on the Lotus which did not list Plaintiff as a lienholder in the application. Plaintiff's Exhibit 14, p. 3.

Defendant obtained the certificate of title, shipped the Lotus to California, and sent the "clean" title to Cove Motoring. Defendant appreciated that by sending Cove the title without Plaintiff noted thereon, Cove could transfer or dispose of the car without payment to Plaintiff. Defendant testified he is unsure whether the Lotus has been sold.

Defendant wrongfully exercised dominion over Plaintiff's collateral, the Lotus. Defendant obtained a title certificate to the vehicle that did not reflect Plaintiff's lien interest. He sent the Lotus to California, and gave the title to Cove. These actions allowed the vehicle, potentially, to be sold in derogation of Plaintiff's rights. Defendant's conversion was not negligent or reckless, but was instead intentional. Defendant, a person with considerable sophistication in the field of automobile sales, knew he could not sell the vehicle, or give the car to Cove to sell, if the title reflected that Plaintiff held a lien on the car. While Defendant argues he had the clean title issued to facilitate a quick sale so Plaintiff could be paid, the Court does not believe Defendant. Defendant's conversion of Plaintiff's collateral renders Defendant's debt to Plaintiff, or at least a portion of it, excepted from discharge under Section 523(a)(6).

Finally, the Court must determine what damages Plaintiff sustained as a result of Defendant's conduct. The amount excepted from discharge where

property is converted is equal to the value of the property on the date of conversion. *Peasley Transfer & Storage Co. v. Smith*, 979 P.2d 605, 615 (Idaho 1999) (recognizing the measure of damages for conversion is the fair market value of the property at the date of conversion); *Averill Machinery Co. v. Vollmer-Clearwater Co.,* 166 P. 253, 254 (Idaho 1917) (Idaho Supreme Court determines measure of damages for conversion to be the value of converted property at the time of conversion plus interest). Of course, Plaintiff would not be entitled to recover more than the balance due on Defendant's loan.

Neither party submitted evidence to the Court concerning the value of the Lotus when it was sent to California in April, 1999. The Court cannot determine the amount of Plaintiff's damages. Therefore, this adversary proceeding will be scheduled for an additional evidentiary hearing as to this limited issue only. In the alternative, by written stipulation, the parties may submit any testimony or evidence they intend to offer on the issue of damages by affidavit prior to the hearing date, in which case the Court will consider vacating the hearing.

IV. Conclusion

Plaintiff was not justified in relying upon any false and deceptive statements made by Defendant to Plaintiff. As a result, Defendant's debt to Plaintiff is not excepted from discharge under Section 523(a)(2)(A). However, because Defendant willfully and maliciously converted the Plaintiff's security interest in the Lotus, Plaintiff's claim against Defendant is excepted from discharge under Section 523(a)(6) to the extent of the balance due on the loan or the value of the vehicle, whichever is less. The parties will be allowed, either at an evidentiary hearing, or by stipulation in writing, to supplement the record with evidence of the amount of Plaintiff's nondischargeable claim.

DATED This _____ day of June, 2000.

_____
JIM D. PAPPAS
CHIEF U.S. BANKRUPTCY JUDGE

CERTIFICATE OF MAILING

I, the undersigned, hereby certify that I mailed a true copy of the document to which this certificate is attached, to the following named person(s) at the following address(es), on the date shown below:

Office of the U.S. Trustee
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ADV. NO.: 99-6268

CAMERON S. BURKE, CLERK
U.S. BANKRUPTCY COURT

DATED:

By_____
Deputy Clerk